Supreme Court, U.S.
FILED
AUG 29 1988
JOSEPH F. SPANIOL, JR.
CLERK

(2)

No. 88-186

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

THOMAS TEW, as Trustee for ESM Government Securities, Inc., and as Receiver for ESM Group, Inc. and ESM Financial Group, Inc.,

Petitioner,

v.

ARKY, FREED, STEARNS, WATSON, GREER, WEAVER & HARRIS, P.A., and EUGENE E. STEARNS,

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether a *per curiam* order of a Court of Appeals affirming summary judgments against Petitioner on his state-law legal malpractice claims should be reviewed where the order does not conflict with any opinion of this Court or involve any federal issue.

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RESPONDENTS' BRIEF IN OPPOSITION

OPINIONS BELOW

Two of the Judgment Orders of the United States District Court for the Southern District of Florida (Pet. App. 13a-21a) are reported at 655 F. Supp. 1571 (S.D. Fla. 1987), and 655 F. Supp. 1573 (S.D. Fla. 1987). A third Judgment Order of the United States District Court for

the Southern District of Florida (Pet. App. 22a-23a) is unpublished. The decision of the Court of Appeals for the Eleventh Circuit reviewing the judgment orders, reported at 846 F.2d 753 (11th Cir. 1988) (Pet. App. 31a-32a), is a one-line *per curiam* order pursuant to Rule 36-1 of the Court of Appeals for the Eleventh Circuit, which provides for affirmance of lower court decisions without a written opinion under certain circumstances where "an opinion would have no precedential value."

STATEMENT OF THE CASE

Petitioner is Thomas Tew, as trustee and receiver for the various ESM companies. Respondents are the Miami, Florida law firm of Arky, Freed, Stearns, Watson, Greer, Weaver & Harris, P.A. ("Arky Freed") and one of its attorneys, Eugene E. Stearns.[1]

Petitioner sued Respondents asserting, on behalf of ESM, purely state-law legal malpractice claims based on negligence. (Pet. App. 1a-10a.) In essence, Petitioner alleged that Respondents learned that their sometimes client ESM was engaged in "an ongoing fraud" to conceal its insolvency or extensive losses, and that Respondents breached their duty to ESM by failing to disclose this information to ESM's auditors, Alexander Grant & Co. ("Grant"), in

[1] It is highly unfair that of the many lawyers who represented ESM over the period of its fraudulent conduct, Petitioner has elected to sue only Mr. Stearns individually. This is especially true given the fact that, as the district court noted, "the record in this case establishes without question that Mr. Stearns did virtually no work at all for ESM." (Pet. App. 19a.)

their responses to the annual auditor's request letters.[2] (Pet. 13; Pet. App. 1a-10a.) Respondents' vigorously denied any such knowledge and asserted, *inter alia*, that: (1) Respondents owed ESM no such duty of disclosure under controlling state law; and (2) the admitted knowledge of and complicity in the fraud by ESM and all its shareholders, directors and officers barred ESM, and hence Petitioner (who is asserting ESM's claims), from recovery for Respondents' alleged negligence.

In the district court, Petitioner filed a motion for partial summary judgment against Respondents. The district court denied Petitioner's motion for summary judgment (Pet. App. 11a-12a.), and granted Respondents' summary judgment motions. (655 F. Supp. 1571; 655 F. Supp. 1573; Pet. App. 13a-23a.) The Court of Appeals for the Eleventh Circuit affirmed *per curiam* in a one-line order. (846 F.2d 753; Pet. App. 31a-32a.)

SUMMARY OF ARGUMENT

The petition completely fails to satisfy the standards for review by this Court. Petitioner's contention that the decisions below conflict with this Court's opinion in *Nix v. Whiteside*, 475 U.S. 157 (1986), is frivolous. *Nix* concerned the issue of whether a criminal defendant's Sixth Amendment right to counsel was violated where his attorney

[2] It is undisputed that ESM bribed the partner-in-charge of Grant's Fort Lauderdale, Florida office to issue fraudulent financial statements for ESM. That auditor (like each of ESM's owners) is now in prison, convicted of fraud for his role in the ESM scandal.

refused to cooperate with the defendant in presenting perjured testimony; it had nothing to do with civil liability for malpractice under state law. (*See* Point I, *infra.*)

None of the other criteria that would warrant review are present. This case involves no federal claims—constitutional, statutory or common law. (*See* Point II, *infra.*)

Petitioner asserts that this case involves important public policies. However, the existence of an allegedly important state law public policy issue is not a basis for review, and this Court has no power to fashion state common law. Furthermore, it is absurd to suggest that certiorari is needed to "correct" misconceptions of law in a one-line *per curiam* order of a court of appeals. (*See* Point III, *infra.*)

Petitioner's claim that the decisions below are incorrect also provides no ground for review. This Court is not primarily concerned with the correction of lower court errors, or with determining whether summary judgments in individual cases were correct. Moreover, the lower court decisions are correct. (*See* Point IV, *infra.*)

ARGUMENT

I.

THE JUDGMENTS BELOW DO NOT CONFLICT WITH ANY DECISION OF THIS COURT.

Petitioner's only attempt to come within the standards for review set forth in Supreme Court Rule 17 is an argument that the lower courts' judgment orders somehow conflict with this Court's decision in *Nix v. Whiteside*, 475 U.S. 157 (1986). That argument is frivolous.

Nix involved the federal constitutional issue of "whether the Sixth Amendment right of a criminal defendant to assistance of counsel is violated when an attorney refuses to cooperate with the defendant in presenting perjured testimony." 475 U.S. at 159. The only issues in this action relate to common law duties and defenses in a legal malpractice action under Florida law. *Nix* had nothing whatsoever to say regarding whether an attorney may be civilly liable to his client under state law for the attorney's failure to disclose the client's own wrongdoing. Indeed, in *Nix* the Court emphasized that "a court must be careful not to . . . constitutionalize particular standards of professional conduct and thereby intrude into the state's proper authority to define and apply the standards of professional conduct." 475 U.S. at 165.[3] Petitioner ignores this admonition, and improperly asks this Court to enunciate rules on state law issues, a matter as to which this Court lacks authority.

II.

REVIEW IS UNWARRANTED BECAUSE THIS CASE INVOLVES NO FEDERAL QUESTION.

All of the criteria articulated by this Court as warranting review involve either conflicting decisions (not applicable here) or the presence of federal questions. *See* Supreme Court Rule 17. This case, however, involves no

[3] *See also* concurring opinion of Brennan, J., 475 U.S. at 176 ("This Court has no constitutional authority to establish rules of ethical conduct for lawyers practicing in the state courts. Nor does the court enjoy any statutory grant of jurisdiction over legal ethics."); concurring opinion of Blackman, J., 475 U.S. at 189-190.

federal issues whatsoever.[4] Rather, the only issue here is whether Respondents may be liable to their client under Florida law for failing to disclose the client's own fraud. (Pet. App. 1a-10a.)

III.

PETITIONER'S CLAIM THAT THE CASE INVOLVES IMPORTANT STATE PUBLIC POLICY ISSUES DOES NOT CONSTITUTE A BASIS FOR REVIEW.

Petitioner also asserts that certiorari is somehow appropriate because this case involves important public policies. (Pet. 13-14.) By the nature of the case, these must be state law policies. However, the presence of state law issues is not a basis for certiorari.

In *Huddleston v. Dwyer*, 322 U.S. 232, 237 (1944), this Court stated that, "ordinarily we accept and therefore do not review, save in exceptional cases, the considered determination of questions of state law by the intermediate federal appellate courts." The 1980 revisions to Supreme Court Rule 17 "pointedly omitted a long-standing provision . . . that gave certiorari relevance to a court of ap-

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[4] For this reason, Petitioner's references to the securities laws and his reliance upon *In re Carter & Johnson*, SEC Admin. Proc., File No. 3-5464, Release No. 17597 (February 28, 1981), are completely misplaced. *Carter* involved an administrative decision concerning whether certain attorneys were to be permitted to continue to practice before the Securities and Exchange Commission. Accordingly, the decision involved a lawyer's obligations under the federal securities laws. Moreover, in that federal administrative proceeding, the attorneys had been expressly retained to give advice about the disclosure requirements of the federal securities laws. Here, Petitioner has not alleged violations of the securities laws or even alleged that Arky Freed was retained by ESM to assist ESM's compliance with any federal disclosure requirements. (See pp. 8-11, *infra*.)

peals decision resolving 'an important state or territorial question in a way in conflict with applicable state or territorial law.' " R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 212 (6th ed. 1986) (hereinafter "Stern & Gressman at ____"). "The omission doubtless reflects the Court's lack of interest in reviewing . . . cases where the only certiorari ground is an alleged conflict with applicable state law." *Id.* at 195.

Indeed, this Court has no authority to issue controlling decisions to clarify or settle issues of state law. Under these principles, this Court's review of the appellate court's order involving purely state law issues is unwarranted, and the petition should be denied.

Moreover, it is ridiculous to suggest that it is necessary for this Court to "correct" a court of appeals decision which consists of a one-line *per curiam* affirmance. This is particularly true since (contrary to Petitioner's suggestion) the decision may have been based on either of two alternative grounds (*see* pp. 8-14, *infra*), so that it is not possible even to guess at the precise basis for the decision.

IV.

THE LOWER COURTS' ALLEGED ERROR PROVIDES NO BASIS FOR REVIEW AND, IN ANY EVENT, THE DECISIONS BELOW ARE CORRECT.

Petitioner also argues that this Court should review this case because the lower courts erred and because there supposedly existed contested factual issues precluding summary judgment. (Pet. 26-27.) Even assuming, *arguendo*, that these contentions are correct (and they are not), the contentions provide no basis for review. This Court is not "primarily concerned with the correction of errors in lower court decisions" (Stern & Gressman at 221), par-

ticularly where the alleged errors relate to state law claims. *Cf.* Supreme Court Rule 17; *Huddleston*, 322 U.S. at 232; Stern & Gressman at 195, 212. Also this Court does not "grant certiorari to review evidence and discuss specific facts." *United States v. Johnson*, 268 U.S. 220, 227 (1925); *see also Texas v. Mead*, 465 U.S. 1041, 1043 (1984) (Stevens, J.). Certainly there is no basis for review in this Court of a case involving what Petitioner calls "unique facts." (Pet. 14.)

Furthermore, the court of appeals' decision was based on one or both of two alternative grounds. On either ground, the decision was correct.

A. Respondents Owed ESM No Duty Of Disclosure.

One of the two possible grounds for the court of appeals' decision (and the basis of the district court's decisions) was the conclusion that Respondents owed no legal duty to ESM to disclose their alleged knowledge of ESM's financial problems to ESM's auditors in annual audit response letters. Because Respondents were not retained by ESM to devote substantive attention to ESM's financial problems, and were never asked to comment on those problems, Respondents owed no duty of disclosure to ESM, whether the case is analyzed under common law principles, under the definitive American Bar Association "Statement of Policy Regarding Lawyer's Responses to Auditors' Requests for Information" (the "ABA Statement"), or under Florida Disciplinary Rule DR 7-102(B) ("DR 7-102(B)").[5]

[5] Petitioner claims that summary judgment was improperly granted because "genuine issues of material fact [exist] as to Arky Freed's . . . knowledge of ESM's insolvency and ongoing fraud." (Pet. 26,

(Footnote continued on following page)

Under controlling Florida law, a lawyer owes his client a duty relating only to matters within the scope of his retainer by that client. *Southern California Funding, Inc. v. Hutto*, 438 So. 2d 426, 429 (Fla. Dist. Ct. App. 1983), *review denied*, 449 So. 2d 265 (Fla. 1984); *Ginsberg v. Chastain*, 501 So. 2d 27, 29 (Fla. Dist. Ct. App. 1986).

The same conclusion follows if the duty issue is analyzed under the ABA Statement, which has, since 1976, been followed by practicing lawyers as "the Bible" for lawyers' responses to auditors' inquiries.[6] Paragraph 2 of ABA Statement emphasizes that a lawyer's duty of disclosure in responding to an auditor's request for information "is properly limited to matters which have been given sub-

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[5] *continued*
footnote omitted.) Petitioner devotes no less than nine pages of its brief, to its version of the "facts" allegedly showing Respondents' knowledge. (Pet. 5-13, 27.) While Respondents strongly deny knowledge of ESM's insolvency or financial problems, the factual issue of Respondents' alleged knowledge is irrelevant here. Petitioners moved for summary judgment on the grounds that they owed ESM no duty of disclosure, even assuming, *arguendo*, that they knew of ESM's financial problems, and that ESM's own fraud barred this action. The only facts relevant to these dispositive issues were indeed undisputed: (1) Respondents were never retained to devote substantive attention to ESM's financial problems or insolvency; (2) ESM's audit inquiries never specifically identified nor specifically requested Arky Freed to comment on ESM's financial problems or insolvency; and (3) all of ESM's shareholders, directors and officers were active participants in the very fraud Respondents allegedly failed to disclose.

[6] Petitioner's attempt to minimize the ABA Statement's importance (Pet. 14-15) ignores the fact that Petitioner's own complaint expressly cites the ABA Statement as creating a duty on Respondent's part (Pet. App. 5a), and that the audit inquiry and response letters (Pet. App. 24a-30a), which Petitioner alleges are "contracts," are copied verbatim from the ABA Statement's forms and explicitly incorporate its provisions. In any event, as noted above, the same limitations on lawyers' duties are found in the malpractice case law, even if the ABA Statement were not treated as controlling.

stantive attention by the lawyer" for the client being audited. ABA Statement ¶ 2; *see also* ABA Statement, commentary to ¶ 2. Paragraph 5 of the ABA Statement also limits an attorney's duty of disclosure to situations where the attorney "has been engaged by the client" to represent or advise it with respect to the claim and has "devoted substantive attention" thereto. ABA Statement ¶ 5.[7]

In addition, Paragraph 5 of the ABA Statement further limits an attorney's duty of disclosure to situations where the client (1) "specifically identifie[s]" a particular unasserted claim in an audit inquiry letter, and (2) "specifically request[s], in the inquiry letter or a supplement thereto," disclosure regarding the possible claim. In the absence of a specific identification of an unasserted claim by a client, and a specific request for comment, an attorney is precluded from making any disclosure. *See* First Report on the ABA Statement at 35.

Here, the district court specifically found on undisputed facts that Respondents were never retained to devote substantive attention to ESM's financial problems or insolvency. (655 F. Supp. at 1572-73; 655 F. Supp. at 1574;

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[7] Petitioner mistakenly relies upon Paragraph 6 of the ABA Statement to support his claim. (Pet. 18.) Paragraph 6, however, merely points out that, "independent of the scope of his response to the auditor's request," an attorney "may have" certain responsibilities (not specified in Paragraph 6) to his client which, as might be expected, are limited to "matters as to which he is engaged." Paragraph 6 contains the same restrictions set forth in Paragraphs 2 and 5 of the ABA Statement: it is applicable only when the judgment that disclosure is required is formed in "the course of performing legal services for the client" about the matter requiring disclosure, and depends entirely "upon the nature of the matters as to which [the attorney] is engaged."

Pet. App. 15a, 19a, 22a-23a.)[8] Moreover, it is undisputed that ESM never identified nor requested Arky Freed to comment on its financial problems in any audit inquiry letter or supplement thereto.[9] *Id.* Accordingly, under Florida common law and the ABA Statement, Respondents owed ESM no duty of disclosure.

Petitioner also claims that DR 7-102(B) created a duty to ESM that required disclosure. (Pet. 25.) DR7-102(B) provides:

> A lawyer who receives information clearly establishing that: (1) His client has, in the course of the representation, perpetrated a fraud upon a person or tribunal shall promptly call upon his client to rectify the same, and if his client refuses or is unable to do so, he shall reveal the fraud to the affected person or tribunal.

Petitioner's argument is incorrect for three reasons.

First, DR7-102, like the Florida common law and the ABA Statement, creates duties only with respect to matters on which the attorney is retained. ("A lawyer who receives information clearly establishing that [h]is client has, in the course of the representation, perpetrated a fraud shall. . . .")

Second, the unambiguous language of DR 7-102(B), concerns a lawyer's obligations to the public and the court,

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[8] Petitioner belatedly argued in the court of appeals that there was some unspecified factual dispute about this point. This argument was untimely and wrong and, in any event, an argument that a lower court made an error as to whether factual disputes exist in an individual case is not a basis for review.

[9] Obviously ESM would do no such thing; it was actively covering up its losses and bribing its auditor, Grant, to conceal its true financial condition.

not the lawyer's obligations to a client like ESM. (A lawyer shall reveal the client's fraud "to the affected person or tribunal.")

Third, the provisions of DR 7-102(B) cannot be the basis of a legal malpractice action. The preliminary statement accompanying the Florida Code of Professional Responsibility applicable during the period of Arky Freed's representation of ESM expressly rejects Petitioner's theory that the Florida Code creates any basis for civil liability, stating: "The Code makes no attempt . . . to define standards for civil liability of lawyers for professional conduct." Florida Code of Professional Responsibility Preliminary Statement, Florida Rules of Court (West 1986). Thus, contrary to Petitioner's argument, DR 7-102(B) creates no duty in favor of ESM and thus cannot be used as evidence of negligent breach of a nonexistent duty.

B. Alternatively, The Knowledge And The Fraudulent Conduct Of ESM's Officers, Directors And Shareholders Bars This Action By ESM's Receiver/Trustee

Petitioner completely ignores the alternative ground upon which the Eleventh Circuit's judgment order may have been based, namely that the knowledge and fraud of ESM and all of its shareholders, directors and officers bars this action. Although the court of appeals' *per curiam* order does not reveal the basis for its decision, this alternative ground was fully briefed below, and the court of appeals at oral argument specifically requested supplemental briefs on the issue. Petitioner cannot be heard to complain that the court of appeals erred when he completely ignores one of the grounds upon which the Eleventh Circuit might have based its decision.

There is no dispute that ESM and all its shareholders, directors and officers engaged in one of the most massive

financial frauds in this country's history. (Pet. 2-3.) Petitioner, as ESM's receiver/trustee, purports to assert (and could only assert) malpractice claims belonging to ESM. Had ESM—the perpetrator of the fraud—pursued the claims now asserted by Petitioner, its own fraudulent conduct would bar those claims. Petitioner is likewise barred. These conclusions follow from a few well-established principles.

In asserting that Respondents committed malpractice against ESM, Petitioner, as trustee/receiver, stands in ESM's shoes and is subject to all defenses Respondents would have against ESM. 11 U.S.C. § 541; *Bank of Marin v. England*, 385 U.S. 99, 101 (1966) (bankruptcy trustee); 4 Collier on Bankruptcy ¶ 541.10(1) at 541-64 (15th Ed. 1986); *Armstrong v. McAlpin*, 699 F.2d 79, 89 (2d Cir. 1983) (receiver). Petitioner necessarily admits that he seeks to assert only ESM's malpractice claims. (Pet. 3-4.) Indeed, if Petitioner had tried to assert malpractice claims belonging to third parties, such as ESM's creditors, he would be precluded by the Florida rule that lawyers are not liable to non-clients for malpractice. *See, e.g., Angel, Cohen & Rogovin v. Oberon Inv., N.V.*, 512 So. 2d 192 (Fla. 1987).

Because the ESM Companies were closely held corporations, managed and controlled by the same few individuals who owned all of the stock, the knowledge of these individuals regarding ESM's fraud is imputed to ESM. *See, e.g., El Ranco, Inc. v. First Nat'l Bank of Nev.*, 406 F.2d 1205, 1215 (9th Cir. 1968), *cert. denied*, 396 U.S. 875 (1969).

It follows from these principles that Petitioner's claims are barred for several reasons. First, there can be no liability to a client for failing to disclose what the client, and all of its officers, directors and shareholders, already know. There is no breach of duty, and the nondisclosure is

not the proximate cause of ESM's losses. *See, e.g., Flagg v. Seng*, 60 P.2d 1004, 1007-08 (Cal. App. 1936).

Put another way, ESM's massive fraud bars Petitioner's malpractice claims, even assuming, *arguendo*, that Respondents knew of the fraud, under the well-settled principle of law that "one who engages in a fraudulent scheme, forfeits all right to the prosecution of a lawsuit." *Horjales v. Loeb*, 291 So. 2d 92, 93 (Fla. Dist. Ct. App. 1974). Even if the defendant is also guilty of wrongdoing, a suit by the perpetrator of a fraud is barred under the doctrine of *in pari delicto*. *Kulla v. E.F. Hutton & Co.*, 426 So. 2d 1055, 1057 (Fla. Dist. Ct. App. 1983).

Petitioner's claims are likewise barred under the doctrine of unclean hands. *Marshall v. Marshall*, 386 So. 2d 11, 12 (Fla. Dist. Ct. App.), *review denied*, 392 So. 2d 1377 (Fla. 1980); *Yost v. Rieve Enterprises, Inc.*, 461 So. 2d 178, 184 (Fla. Dist. Ct. App. 1984), *review denied*, 469 So. 2d 750 (Fla. 1985); *see also Whitelock v. Geiger*, 368 So. 2d 372, 374 (Fla. Dist. Ct. App. 1979). The unclean hands principle has been specifically applied to bar legal malpractice actions by plaintiffs who were involved in the misconduct about which they complained. *Robins v. Lasky*, 123 Ill. App. 3d 194, 462 N.E.2d 774, 779 (1984); *Kirkland v. Mannis*, 55 Or. App. 613, 639 P.2d 671, 673, *review denied*, 292 Or. 863, 648 P.2d 850 (1982).

CONCLUSION

For the reasons stated herein, the petition for a writ of certiorari should be denied.

Respectfully submitted,

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